MARKET UPDATE

Monthly Market Summary for Members of DFMC

Dairy Farmers Milk Co-operative

May 2010

Situation & Outlook: positive picture

The annual industry outlook has been released showing a brighter future for milk producers and export manufacturers.

The 2010 Situation & Outlook report, a joint production between Dairy Australia and Freshlogic (who prepares this newsletter for DFMC), has been released showing a brighter 2010/11 for southern producers but a bit of supply:demand reality in northern regions. Three key points for milk producers as contained in the package are:

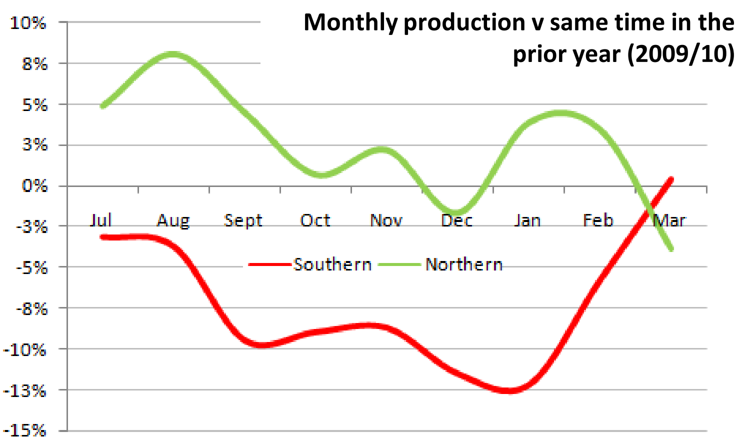
- Dairy manufacturers (MG, Fonterra, WCB) will pitch full year milk prices at between \$5.00/kgms and \$5.40/kgms (37-40cpl). They are likely to open at \$4.40 to \$4.60 – a little higher than where they will close in 2009/10
- Northern prices will fall 5-7cpl but the range in Qld will widen as Parmalat prices remained fairly fixed until 2012
- The domestic dairy market – where most of your milk goes – will remain pretty tough as a slow, nervous economic recovery continues. Ongoing capture of market share by brands will continue but retailers will continue to use price as a weapon.

Milk production steadied in March

Our lines have crossed in the latest milk production numbers

National milk production was down slightly in March 2010 and year to date output remained 5.8% down on the prior year. But the worms on monthly comparisons with the prior year for the two regions we track in this newsletter have crossed! Northern milk flows were down on the same month last year; southern milk was very slightly up.

Season-to-date production in southern states was 7.7% down by the end of March, while in northern regions (Qld and NSW) the slow-down in production continued to 2.4% above the prior year.



Woolworths' slowing growth

Coles is gaining ground on its bigger rival.

Woolworths has recorded a 4.7 per cent improvement in its third quarter sales, but has lowered its full-year sales forecast due to weak inflationary pressures. Same-store food and liquor sales were only up 1.6% in Australian stores - well below the growth rates of recent quarters, and less than half of that being achieved by rival Coles.

Woolworths has taken a dimmer view of prospect for the rest of the year. Given the greater than anticipated impact on sales of low food and liquor inflation and the cycling of stimulus effects, it sees the second half of the year to continue to be impacted by low price inflation.

Important market indicators	
Dairy export index	The index has risen to 145pts , up about 7% on the last month
World dairy prices	All spot prices have steadily , which is good comfort in view of the recent rises in April
Grain futures	Prices in US have continued at weak levels due to oversupply. Australian futures prices also remain steady
Cow prices for cull exports to the US	The US market for Aussie cull cows continues to rise – despite a strong \$A

Retail sales doing it a bit tougher

ABS reflects food retailing still in a downward slump.

Compared to a fall in the sales by 1.2 per cent in February, the latest ABS retail trade figures have revealed a rise in the sales by 0.3 per cent in March. Cafes, Restaurants & Takeaway Food Services have grown more than 13% over the past 6 months compared with the period to March 2009, while Food Retailing (which includes supermarkets) is growing at less than a third of that pace. volume growth.

The varying fortunes for grocery and non-grocery segments of the retail market have mixed news for the dairy industry. The grocery market is still growing steadily but also showing some average price gains as brands take a bit of ground back from the private label. But outside the store in other channels, where there is better volume growth but more contestability for shares, prices are suffering as everyone wants a slice of the growth. This is evident in butter and non-cheddar cheese prices.

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World dairy market returns

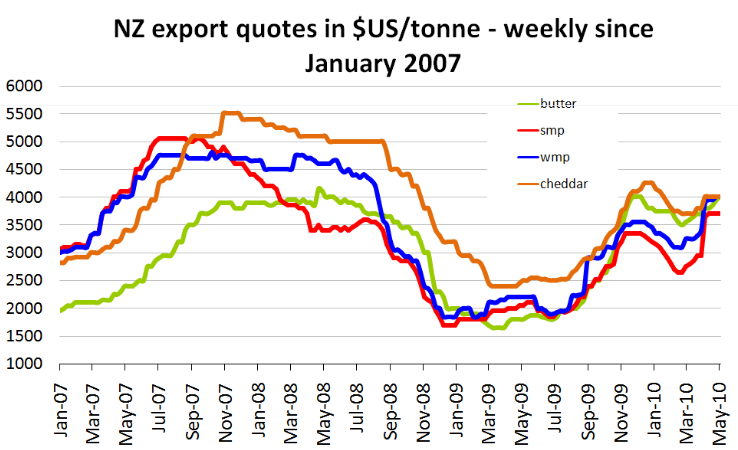
Prices steady, dollar remains the enemy

At the time of this report the index of Australian export returns had climbed in net terms by about 9 points over the past few weeks, with slightly stronger spot prices and a sharp fall in the value of the $A.

The index may be a little flattered by the effects of the European debt crisis which caused the $A to lose 4c over 2 days a week before this went to print. We'd expect the dollar to rise a little to take the edge off the happiness in the index! But that depends how the currency market starts to deal with the potential effect on commodity markets of a slowing in the growth of China.

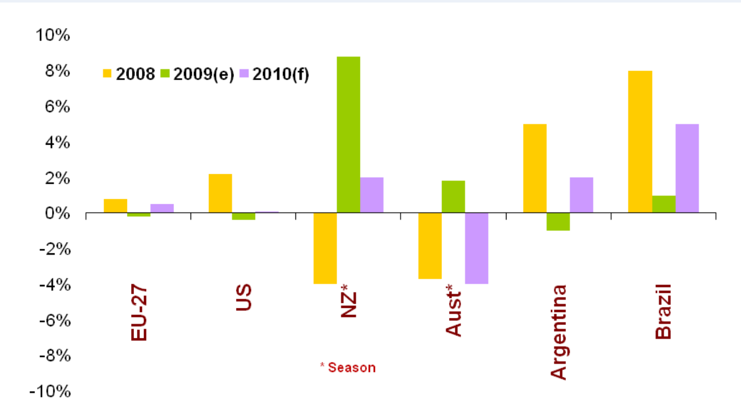
GDT auction holds its nerve

The average price for WMP slipped just a little in a very important auction event in early May, down 1.2% below a month earlier to US$3,932 per tonne after the strong surge in April. The price for the first two contracts for WMP declined, the third contract, which covers November to January delivery, gained 3.5% to US$3,908, as buyers looked to secure their later supply in anticipation of continued demand. The average price for anhydrous milk fat gained 4.4% to US$5,020 per tonne, while the average price for skim milk powder slipped just 1.6% to US$3,612. The trade-weighted globalDairyTrade index, a measure of the average price across all products, has edged down 0.8%.



Why the market is tight?

An important chart we dug out of this year's S&O report to help explain why the world market is tight – the size of the purple bars on this chart adds up to the fact that there is less milk around, especially the NZ line which makes up 40% of world exports alone. Climate change working in our favour for once.



Take note: The index is an indicator of spot trends in gross export returns to the industry based on quoted Australasian export prices, movements in currency and the total milk usage in exports by the Australian industry. It was set at 100 on 1 January 2004.

Source: Freshlogic

Fonterra launches price index

GDT events serve as the launching pad for Fonterra's price index.

Fonterra has announced that it will be launching a dairy price index based on the GDT events. The new trade weighted index will cater to the need for a constant "headline" number, which tracks the market for these products, as per Fonterra. Fonterra has also added that the index will show the percentage change in the average price of a basket of product, including whole milk powder, skim milk powder, and anhydrous milk fat, which are currently being traded on the globalDairyTrade. Instead of describing the prices, Fonterra will be showing an index of 1000 points on the basis of the prices paid in March 2010.

Chinese dairy players show recovery

China's Yilli signals bullish return to form...

The latest financial results showcase the comeback of Chinese dairy companies in the post-melamine recovery period. Inner Mongolia Yili Industrial Group has reported a 12.3% rise in revenue to CNY24.32bn (US$3.5bn), and profit up 138% to CNY647.66m (US$94.9m). Yili also aims to attain the largest share of the dairy market sales this year, in addition to earning the reputation for delivering quality through its brands.

Mengniu Dairy has also reported a profit of 1.116 billion yuan (US$170 million) in 2009, an improvement from a loss of 950 million yuan (US$139 million) in 2008. The company reported a massive increase in the use of imported milk powders which allowed a lift in margins due to the lower cost of the imported product compared with locally sourced product.

These results are important as they show good recovery in demand – but what is more important in China is how much powder they will import due to the loss of trust in local powder production. The steady recovery in quality along the Chinese supply chain may take a couple of years but it will in the meantime keep the powder market in short supply.

US supply rebuilding but fragile

The weakening of the US farmgate prices may dent a small recovery in production that is underway.

There were 193,000 fewer cows being milked in March compared to the year before, with the numbers indicating a sizable leap in per-cow output in March itself. USDA projects that total production in the US will be 0.2% up for the 2010 year – after the first quarter production has quickly reversed the slump of late last year to be line-ball with the first quarter of last year.